

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer
Marshall Johnson
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Gregory Scott

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of 1-800-RECONEX, Inc.'s
Petition for a Certificate of Authority to
Provide Local Exchange Service in Minnesota

ISSUE DATE: January 28, 2004

DOCKET NO. P-5957/NA-03-1018

In the Matter of 1-800-RECONEX, Inc.'s
Petition for a Certificate of Authority to
Provide Long Distance Service in Minnesota

DOCKET NO. P-5957/NA-01-884

ORDER DENYING APPLICATIONS FOR
AUTHORITY, WITHOUT PREJUDICE

PROCEDURAL HISTORY

On July 2, 2003, 1-800-RECONEX, Inc. (RECONEX or the Company) filed for a Certificate of Authority to provide local exchange service in Minnesota. On the application, RECONEX disclosed that it had previously been denied certification in Alaska, New Hampshire and South Dakota and provided explanations for each denial.

On September 4, 2003, the Minnesota Department of Commerce (the Department) filed comments recommending that the Commission deny RECONEX's petition. The Department indicated that it believes that RECONEX has not demonstrated that it possesses the necessary managerial, technical and financial qualifications to operate in Minnesota.

On September 8, 2003, the Residential and Small Business Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments also recommending that the Commission deny RECONEX's petition. The RUD-OAG also expressed concerns regarding RECONEX's qualifications to operate in the state of Minnesota.

On September 26, 2003, RECONEX filed reply comments. RECONEX addressed the specific concerns of the Department and the RUD-OAG, arguing that the Company does have the qualifications to operate in Minnesota and should be granted a certificate of authority.

The Commission met on January 15, 2004 to consider this matter.

FINDINGS AND CONCLUSIONS

I. THE DEPARTMENT'S OPPOSITION

The Department noted that the Commission may not issue a certificate to provide local facilities-based service unless the applicant establishes that it has the financial, technical, and managerial capability to provide the services described in its petition consistent with the public interest, including the requirements of Chapter 237 of the Minnesota Statutes, and all other applicable laws, rules, and Commission Orders.¹

The Department recommended that the Commission deny RECONEX's application because, in the Department's view, the Company has not borne its burden to show that it has the necessary managerial, technical, and financial qualifications to operate in Minnesota.

The Department cited three main reasons why it believes RECONEX's application should be denied. First, RECONEX has been the subject of serious adverse administrative action in other states. Second, RECONEX failed to disclose past and present regulatory action against it in Colorado either in its application, as required by Minn. Rules, Part 7812.0300, subp. 2, or in response to a specific Information Request (IR) from the Department. Third, the Department noted that the Commission had previously placed RECONEX's long distance application² on hold until the Company provided it with additional information on the ongoing regulatory action in Washington. In so doing, the Department argued, the Commission indicated its interest in closely scrutinizing a new application from a carrier whenever the carrier has been the subject of proceedings in other states.

The Department also noted that RECONEX had failed to disclose in its July 2, 2003 application or in its subsequent response to Department Information Requests (IRS) that on September 2, 2001 the Washington Commission had issued an Order against the Company, an Order that has remained valid to this day.

The Department also stated that RECONEX's financial statements show that it does not have positive equity, as required by Minn. Rules, Part 7812.0300, subp. 3(E). The Department cited updated financial data submitted by RECONEX in Colorado that shows a growing negative shareholder equity and a worsening working capital position.

The Department stated that Minn. Stat. §§ 237.66, 237.662, and 237.663 require carriers to disclose any termination liability assessments (TLAs) in writing at the time the customer signs up and that the Company's statements regarding how and when it planned to disclose its termination liability assessments (TLAs) violated its obligations under those statutes.

¹ Minn. Rules, part 7812.0300, subpt.3.

² Docket No. P-5957/NA-01-884.

Finally, the Department stated that RECONEX's announced intent to charge a higher rate for stand alone local service than it would charge for bundled local and long distance service was illogical and served only to relieve the Company of its requirement under Minn. Rules, Part 7812.0600, subp. 1(C) to provide equal access to long distance carriers and is unreasonably discriminatory. The Department stated that if the Commission granted RECONEX authority, it should be conditioned on requiring RECONEX to show that this practice is not discriminatory under Minn. Rules, Part 7812.2210, subp. 5.

II. THE RUD-OAG'S OPPOSITION

The RUD-OAG stated that RECONEX has a questionable financial ability, a history of regulatory problems in other states, and has proposed to provide service in a manner that fails to comply with current state legal requirements. The RUD-OAG provided specifics to support each statement. The RUD-OAG concluded that RECONEX has failed to establish that it has the requisite financial, managerial, and technical skills necessary to provide telephone service in this state. In addition, the RUD-OAG argued, RECONEX's application is not in the public interest because it has failed to demonstrate that it will provide service in compliance with applicable state legal requirements.

The RUD-OAG argued that, for these reasons, the Commission should deny RECONEX's application for a certificate of authority.

III. RECONEX'S POSITION

A. Managerial Skills

With respect to the administrative actions taken against it in other jurisdictions and allegations that it had failed to fully disclose those actions, RECONEX reviewed each administrative action potentially qualifying for such mandatory disclosure and argued that with the exception of the Colorado Order to Show Cause for providing local exchange service without proper certification issued in 1998, the Company has disclosed all actions pursuant to Minn. Rules, Part 7812.0300, subp. 2. While taking full responsibility for failing to disclose the Colorado Order to Show Cause, the Company denied that the other matters required disclosure. The Company argued that it was unreasonable to think that the Company would risk its certification by not disclosing those matters if it thought that disclosure was required.

In addition, RECONEX denied the Department's statement that RECONEX had attempted to characterize the regulatory actions taken against it in Washington and Oregon as minor. The Company stated that since it was based in the Northwest, these two actions were of the most critical concern to the Company and that the Company addressed them accordingly.

B. Financial Condition

RECONEX also offered comments to offset concerns about the Company's financial viability. The Company did not deny that it has and continues to have a negative shareholder equity in violation of Minn. Rules, Part 7812.0300, subp. 3, but noted several explanations or positive indicators, including the following:

- 1) the Company has a generally positive EBITDA³ and projects being net income positive in August, 2004;
- 2) the Company's roll-out of a new product, building purchase, and the stock redemption of a 20% stockholder make cash flow tight in the short term, but will lead to a more financially sound company in the long term;
- 3) the Company is currently enjoying a 20% monthly increase in its customer base, which is coincident with high up-front cost, primarily in the nature of advertising/customer acquisition costs and credit extension;
- 4) several other Commissions have understood this short-term negative impact on the Company's financials and the Company has obtained forty facilities-based approvals, all with financial statements that show negative shareholder equity; and
- 5) the Company succeeded with its prepaid product and there is nothing to indicate that it will not be successful with the postpaid product.

The Company stated that it understood the Minnesota Rules regarding shareholder equity and stated that it would be willing to accept any conditions that the Commission deemed appropriate, such as monthly production of its financial statements so that the Commission could chart the Company's progress.

C. Legality of Service Offerings

RECONEX acknowledged that several of its service offerings as described in its tariff initially did not comply with Minnesota rules and that even after working with the Department and the RUD-OAG there remained issues with respect to termination liability assessments (TLAs), stand alone service (including equal access), and the telephone assistance plan (TAP) . RECONEX attributed these differences to the fact that it does not try to submit a tariff that meets the state's rules, but instead submits a model tariff and then learns from the state's regulatory staff what the state's rules are.

³ EBITDA is "earnings before interest, taxes, depreciation and amortization."

RECONEX stated that it is willing to work with the Department to make any further necessary changes, as it has in every other jurisdiction in which it provides service.

IV. COMMISSION ANALYSIS AND ACTION

An applicant such as RECONEX that seeks a certificate of authority to provide facilities-based service must bear the burden of showing that it has the financial, technical, and managerial capability to provide the services described in its petition consistent with the public interest. The applicant must show that its provision of service will be consistent with the requirements of Minnesota Statutes, Chapter 237, including 237.16, and all applicable laws, rules, and Commission Orders.⁴

After considering the Company's filings and oral argument, the Commission finds that RECONEX has not borne that burden. Accordingly, the Commission will deny the Company's application. In so doing, however, the Commission clarifies that the denial is without prejudice in that the Company may reapply if it believes that circumstances have changed that will allow it to establish the requisite financial, technical, and managerial capability.

The Commission reaches this conclusion based on Minn. Rules, Part 7812.0300, subp. 3, which specifies the criteria that the decision to grant a certificate under this part must be based upon. Criteria of particular concern are the following:

Minn. Rules, Part 7812.0300, subp. 3, B: The applicant's personnel, staffing, equipment, and procedures, including the extent to which these are adequate to ensure compliance with the commission's rules and orders relating to service requirements, service quality, customer service, engineering, accounting, and other relevant areas.

The Commission notes that the Company's announced *modus operandi* is to not know the rules of the state in which it seeks to operate and to learn as it goes, relying on regulatory personnel in those states to prompt it into compliance.⁵ This approach appears to assure on-going catch-up, adopting "temporary" non-compliance as the norm, non-compliance that will continue until the state's regulatory staff brings the non-compliance to the Company's attention and enforces compliance. This approach indicates that the Company plans not to have the capacity to ensure compliance with Minnesota requirements.

Minn. Rules, Part 7812.0300, subp. 3, C: The extent to which the applicant has had any civil, criminal, or administrative action taken against it in connection with the applicant's provision of telecommunications services.

⁴ See Minn. Stat. § 237.16, subd. 1 and Minn. Rules, Part 7812.0300, subpt. 3.

⁵ See the Company's Reply Comments, September 26, 2003 at page 25.

The Commission notes an extensive record of regulatory actions taken against the Company in states where it has operated, including action taken for providing telecommunications service without having obtained authority to do so and for not complying with a state Commission Order.

Minn. Rules, Part 7812.0300, subp. 3, D: The applicant's cash reserves and the extent to which those reserves or cash equivalent are adequate to meet the petitioner's start-up costs and expenses.

The Company stated that rolling out a new product offering has required significant financial expenditures in terms of product development and marketing. In addition, entering the postpaid arena involves credit extension, creates receivables, and thereby reduces cash. In addition, RECONEX purchased its corporate headquarters and redeemed the stock of a 20 percent shareholder. The Company acknowledges its resulting cash flow is tight, but believes the situation is short term and will lead to a stronger more financially sound company in the long term. The Company's expressed optimism about its prospects and its statement that its three major stockholders have agreed to provide \$850,000 through the end of 2003 is not sufficient in itself to assuage concerns about the Company's on-going financial situation, especially for a facilities based operation that is expanding in multiple jurisdictions.

Minn. Rules, Part 7812.0300, subp. 3, E: The applicant's business or owner equity must be positive.

The RUD-OAG reviewed RECONEX's balance sheet for calendar years 2001, 2002 and the six months ending June 30, 2003. In all instances, RECONEX shareholders' equity was negative: \$5 million in 2001, \$4 million in 2002, and \$5.4 million for the first six months of 2003. The Company stated that it appreciates the Minnesota Rules regarding shareholder equity and understands the concerns raised by the Department and the RUD-OAG and requested approval subject to any financial conditions that the Commission desires. The record does not reflect a set of conditions proposed by the Company and supported by the Department and the RUD-OAG to address the financial concerns.

Minn. Rules, Part 7812.0300, subp. 3, H: Any other factors relevant to determining the applicant's technical, managerial, and financial capability to provide the reasonably adequate services, as described in its petition, consistent with the public interest, including the requirements of this chapter, Minnesota Statutes, section 237.16, and all other applicable laws, rules, and commission orders.

As recounted in the Department's and the RUD-OAG's comments, the Company did not fully disclose information relative to administrative actions taken against it in other jurisdictions in connection with its provision of telecommunications services, either in its application or in response to specific Information Requests. The Company's explanation for these failures to disclose is not persuasive. For example, it appears that the Company decided not to disclose many

of the administrative actions taken against it based on its view that the actions were not adequately “against” the Company, were not “final” enough to warrant disclosure, or were not relevant to the Company’s currently proposed operations.

The rule requires full disclosure of all administrative actions taken against it in connection with its provision of telecommunications service. The relevance or weight to be given the actions disclosed is for the Commission to determine, not the Company. The Company’s failure to understand its need to comply with the disclosure requirement and the explanations it offered for not disclosing are troubling. Taken together, they raise a question whether the Company is willing and able to comply with basic regulatory requirements.

A key ingredient of establishing the requisite “management capability” is an applicant’s ability to establish credibility and confidence the accuracy of its filings. Suffice to say that due to the nondisclosure incidents the Company has not borne its burden of proof in this regard in these dockets.

ORDER

1. The Commission hereby denies RECONEX’s applications for authority to provide local exchange service and long distance service in Minnesota without prejudice.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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